Abbott Announces Breakup Into Two Companies, In-Line 3Q Results

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In tandem with releasing in-line third-quarter results, Abbott ABT announced plans to divide itself into two: a research-based pharmaceutical company and a diversified medical product company. We believe Abbott is splitting up to offer investors distinct and focused investment opportunities as well as to increase the strategic focus of each firm. Based on our sum-of-the-parts analysis, we don't expect to significantly change our fair value estimate as a result of the breakup. However, we believe the breakup should serve as a catalyst for the stock as the investment community will probably appreciate the value of the separate firms more, given the increased clarity of each unit as a stand-alone company.

Abbott will issue new stock in a tax-free distribution for the research-based pharmaceutical company, which is likely to occur by the end of 2012. It expects the combined companies in total will pay a dividend that will equal Abbott's total dividend at the time of separation, which we expect is probably based on typical dividend payout ratios of these two industries. Abbott's current CEO, Miles White, will remain CEO of the diversified medical product group and Richard Gonzalez, the executive vice president of Abbott's current pharmaceutical group, will become CEO of the research-based pharmaceutical company, which we believe makes sense, given the strong backgrounds of each executive.

Third-quarter results were largely in line with our expectations, with total sales increasing 8% operationally year over year, driven by strong growth from immunology drug Humira and sales in emerging markets. We continue to expect strong growth from Humira over the next couple of years based on the drug's leading efficacy and acceptable side-effect profile. We expect emerging markets will further add to growth over the next several years as Abbott's leading position in India will benefit from this fast-growing emerging market. Earnings per share increased 12% from the prior-year period as a lower tax rate helped increase earnings quicker than sales. Abbott confirmed its 2011 earnings per share range of $4.64-$4.66, narrowed slightly from previously issued guidance of $4.58-$4.68. We expect the firm will meet its target.

We are placing our credit rating under review with a negative outlook, as one of the pillars of Abbott's creditworthiness--diversity of operations--is set to decline based on this reorganization. Since we don't expect the firm's capital structure to change much for the splitting entity based on our initial take on the division, we'd still expect the two entities to display very low-risk credit profiles.